

Comments for the Record
U.S. House of Representatives
Committee on Ways and Means
Hearing on Tax Reform and Tax-Favored Retirement Accounts

Wednesday, April 17, 2012, 10:00 AM

By Michael G. Bindner

Center for Fiscal Equity

Chairman Camp and Ranking Member Levin, thank you for the opportunity to submit these comments for the record to the House Ways and Means Committee. Our comments are an expansion of last month's comments and are, as always, in the context of our tax reform plan, which has the following four elements:

- A Value Added Tax (VAT) to fund domestic military spending and domestic discretionary spending with a rate between 10% and 13%, which makes sure every American pays something.
- Personal income surtaxes on joint and widowed filers with net annual incomes of \$100,000 and single filers earning \$50,000 per year to fund net interest payments, debt retirement and overseas and strategic military spending and other international spending, with graduated rates between 5% and 25% in either 5% or 10% increments. Heirs would also pay taxes on distributions from estates, but not the assets themselves.
- Employee contributions to Old Age and Survivors Insurance (OASI) with a lower income cap, which allows for lower payment levels to wealthier retirees without making bend points more progressive.
- A VAT-like Net Business Receipts Tax (NBRT), which is essentially a subtraction VAT with additional tax expenditures for family support, personal retirement accounts, health care and the private delivery of governmental services, to fund entitlement spending and replace income tax filing for most people (including people who file without paying), the corporate income tax, business tax filing through individual income taxes and the employer contribution to OASI, all payroll taxes for hospital insurance, disability insurance, unemployment insurance and survivors under age 60.

Under our proposal, tax deferred accounts will no longer be needed. Returns on investment and savings will be tax free until spent for the vast majority of households. Households who do pay the income and inheritance surtax will need no incentive to save (they already do) and none should be granted to them in the tax code. More importantly for reform is the question of the transition from the current patchwork system of tax deferred and pre-taxed retirement accounts to a system without them.

Some VAT proponents take the position that if the tax replaces taxes paid by employees and shareholders, introduction of a VAT will be price neutral while others contend that it will result in an increase to price levels whenever the rate is increased and upon introduction. As many VAT adoptions occurred in Europe during times of high inflation, the matter is eminently debatable.

Our detailed proposal to the Fiscal Commission in 2010 assumed that there would be a one-time price increase of some level and that during the transition, net pay would be allowed to rise for most wage earners by the same rate as the VAT by adjusting tax withholding tables by that amount. If prices did not increase by the same percentage, this would be a one-time bonus for most workers and an inducement to either save or to increase consumption. Other analysts are also of the view that the perception that VAT introduction will raise prices in the future will result in immediate spending in the period just before introduction. In either scenario, VAT introduction may just kick-start the economy.

An argument against VAT introduction is that it would impose additional taxes on Social Security recipients and individuals who have already invested in Roth Individual Retirement Accounts with funds that have already been taxed.

In order to hold Social Security beneficiaries harmless, there should be a one-time Cost of Living Allowance increase by the same percentage as the tax, as well as an additional increase whenever the VAT rate increases. Additional increases to the base benefit would result to offset any increases to Medicare Part B and Part D premiums. Both of these would be paid for by our proposal to shift the employer contribution from an income capped payroll tax to an uncapped Net Business Receipts Tax.

Roth holders would get a one-time tax rebate on their income taxes equal to the VAT rate based on their account size. Assuming a 10% VAT and a Roth IRA of \$100,000, the rebate would be \$10,000. This rebate could be paid out over a period of years, as most accounts have been accumulated in that fashion. Holders of tax deferred accounts would obviously need no rebate and would simply pay consumption and income taxes upon withdrawal, with income taxes due only if the additional income pushes total income above the income tax floor.

No adjustment to incomes for workers or retirees will be made to offset the NBRT, as this tax is replacing a variety of taxes including payroll taxes for disability insurance, unemployment insurance, hospital insurance, survivors insurance for non-retirees, the employer contribution to old age and older survivors insurance, the corporate income tax, business taxes collected through the personal income tax system and a portion of personal income taxes. Transition to this tax will reduce gross income, but not necessarily net income. Additionally, some families will receive an increase of income due to the introduction of an expanded refundable child tax credit, while others may experience a salary decrease if they have a smaller family size as base wages are reduced within companies to account for the expansion of this credit.

Thank you for the opportunity to address the committee. We are, of course, available for direct testimony or to answer questions by members and staff.

Contact Sheet

Michael Bindner
Center for Fiscal Equity
4 Canterbury Square, Suite 302
Alexandria, Virginia 22304
571-334-8771
fiscalequity@verizon.net

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